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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1948

No. 213

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION (a national banking association),
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

The petitioner, the Bank of America National Trust and Savings Association, by its counsel, prays that a

writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above-entitled cause on June 8, 1948, affirming the decision of the District Court.

OPINIONS BELOW.

The per curiam decision of the Circuit Court of Appeals (R. 300), reported in 168 Fed. (2d) ....., reads as follows:

> "The judgment of the District Court is affirmed for the reasons stated in its opinion and on authority of Virginian Hotel Corporation v. Helvering (4 Cir.) 132 F. 2d 909, affirmed 319 U. S. 523."

The decision of the Circuit Court of Appeals was rendered and filed on June 8, 1948, and the judgment of that Court was entered on the same day. (R. 301.)

The District Court opinion and decision, reported in 69 Fed. Supp. 932, is set forth in the transcript of record herein pages 106-112. The District Court judgment was entered March 14, 1947. (R. 131.)

JURISDICTION.

The jurisdiction of this Honorable Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. (28 U.S.C.A. Section 347.) The judgment sought to be reviewed was entered June 8, 1948.

STATUTE AND SUBJECT MATTER INVOLVED.

This case involves the determination of the amount of the depreciation deduction to which the petitioner is entitled for income tax purposes in the years 1938 and 1939 under Sec. 23(1) of the Internal Revenue Code which reads as follows:

> "In computing net income there shall be allowed as deductions:
>
> (1) Depreciation—a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, * * *"

and more particularly the case involves the determination of the basis for depreciation under Section 113(b)(1)(B) of the Internal Revenue Code (which section though relating to the basis for gain or loss, is made applicable by Section 114(a) of the Internal Revenue Code, for determining the basis for depreciation) which reads as follows:

> "Section 113(a). The basis of property shall be the cost of such property; * * *
>
> "Section 113(b). The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.
>
> (1) General Rule—Proper adjustment in respect of the property shall in all cases be made * * *
>
> (B) In respect of any period since February 28, 1913, for exhaustion, wear and tear,

obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws * * *"

The specific dispute in the case relates to whether in determining the basis for depreciation for the years 1938 and 1939 the cost of the property should be reduced under the provisions of subsection (B) of Section 113(b)(1) above quoted by admittedly excessive depreciation for the years 1932 to 1935 inclusive and whether such excessive depreciation was "allowed" within the meaning of the said subsection.

STATEMENT.

The petitioner brought this action in the District Court of the United States for the Northern District of California, Southern Division, for the recovery of income taxes alleged to have been illegally assessed and collected for the calendar years 1938 and 1939. The case was submitted to the District Court upon stipulations of facts. (R. 28-68.) The Honorable District Court though rendering judgment in favor of petitioner for an amount stipulated to have been overpaid by petitioner, decided against the petitioner on the questions here involved. (R. 130, R. 127-130.) The Honorable Circuit Court of Appeals affirmed the decision of the District Court. (R. 300.) Both the District Court and the Circuit Court of Appeals based their decisions primarily on authority of the decision

of this Honorable Court in the case of *Virginian Hotel Corporation of Lynchburg v. Helvering,* 319 U. S. 523.

The petitioner is claiming a larger deduction for depreciation on buildings, furniture and fixtures in the years 1938 and 1939 than was allowed by the Commissioner of Internal Revenue. It was conceded in the Courts below that the petitioner was entitled to a larger deduction for depreciation on buildings (R. 58, Stip. Par. 27; R. 115, Par. 8) and judgment was entered accordingly. The Courts below concluded, however, that the petitioner was not entitled to any greater depreciation on furniture and fixtures than was allowed by the Commissioner of Internal Revenue and rejected petitioner's claim therefor.

The method employed by the Commissioner of Internal Revenue in computing the annual depreciation deduction was to take the cost of the property as of December 31, 1935,[1] reduce it by depreciation deducted on the original income tax returns for years prior thereto to determine the unexhausted basis of the property, and to spread that unexhausted basis over the estimated remaining years of useful life of the property. (R. 42, Stip. Par. 9; R. 56, Stip. Par. 22f.)

The primary question is whether in computing the unexhausted basis for depreciation as of December 31, 1935 of the buildings, furniture and fixtures owned

---

[1]In the settlement of tax controversies for the years 1936 and 1937, the parties hereto reached an agreement as to the amount of depreciation to be allowed as a deduction for those years (R. 44, Stip. Par. 10), so the matter of the depreciation accumulation for those two years is not in controversy and is not material to the adjudication of the issue in this proceeding.

by the petitioner, the cost of said property should be reduced by *excessive* depreciation erroneously taken as deductions by petitioner on its original income tax returns for the years 1932 to 1935, or by the *correct* depreciation for those years. The answer to this question depends upon whether the excessive depreciation was "allowed" within the meaning of that term as used in Section 113(b)(1)(B) of the Internal Revenue Code hereinbefore quoted, supra p. 3. The Commissioner claims that he "allowed" the excessive depreciation. The taxpayer petitioner claims that the Commissioner did not allow it and could not have allowed it under the law applicable to the particular facts and circumstances of this case.

The District Court incorporated by reference as part of its Findings of Fact, the matters set forth in the stipulations of facts. (R. 114, Par. 2.) The facts, in summary, are as follows:

The petitioner mistakenly reported as a deduction on each of its income tax returns for the years 1932 to 1935 an excessive amount of depreciation on banking premises and on furniture and fixtures. (R. 60-68, Stip. Par. 31-33; R. 58, Stip. Par. 26; R. 272, Ex. 15.) The deduction was excessive *based upon facts reflected on the petitioner's books and records and known at the time the returns were filed.* (R. 46, Stip. Par. 15; R. 48, Stip. Par. 16; R. 57-58, Stip. Par. 25, 26; R. 272, Ex. 15.) The returns themselves directed attention to the fact that there was a difference between the depreciation reported and the depreciation recorded on the books. (R. 60, Stip. Par. 30.) The returns showed net

losses in an amount in excess of the entire deduction for depreciation. (R. 44-46, Stip. Par. 12 to 14.)

Internal Revenue Agents audited these returns, challenged the deductions including the depreciation deductions, and though the depreciation deductions were excessive, the agents deferred any correction thereof until they audited tax returns for later years which disclosed tax liabilities. The agents' action, and the Commissioner's approval thereof, was in accordance with established Bureau of Internal Revenue procedure that when the agent goes far enough with his audit to know that the corrections of any errors would not overcome the reported loss, he is to so report to his supervisors, and the Commissioner of Internal Revenue, if he approves the report, will "accept" the return and send it to the closed files. The agent is not permitted in such cases to spend any time in the preparation of, or in assisting in the preparation of corrected depreciation schedules. (R. 30, 33-36, Stip. Par. 6, Par. 16 to 21; R. 50, Stip. Par. 19, 20.)

When the agents audited the tax returns for 1936 to 1939 inclusive, which involved tax liabilities, they directed and assisted the petitioner in the preparation of revised depreciation schedules for all years 1932 to 1939 inclusive and it is stipulated that these schedules reflect the correct depreciation allowable for the years 1932 to 1935. (R. 53, Stip. Par. 22; R. 58, Par. 26.) The preparation of these schedules was an extensive task, taking over a year to complete at considerable cost to the taxpayer. (R. 53, Stip. Par. 22.) After these

schedules had been accepted by both the agents and the petitioner (R. 55, Stip. Par. 22b), the Commissioner rejected them on the ground that the decision of this Court in the case of *Virginian Hotel Corp. of Lynchburg,* 319 U. S. 523, prohibited the correction of the depreciation taken on the returns for the years 1932 to 1935 and therefore the basis for depreciation at the end of the year 1935 must reflect the reduction of the cost of the property by the depreciation taken on the returns instead of the correct depreciation for those years. (R. 36, Stip. Par. 23, 24; R. 49, Stip. Par. 17; R. 56, Par. 22e.)

The Commissioner contends in effect that when the 1932 to 1935 returns were sent to closed files, he "accepted" them, and thereby "allowed" the depreciation deduction taken thereon even though his agent knew that the deduction was wrong. (R. 36, Stip. Par. 23, 24.)

The Commissioner's action resulted in wiping out approximately $2,000,000 of capital base as of Dec. 31, 1935 ($1,416,279.76 on furniture and fixtures) which otherwise would have been the subject of depreciation deductions in later years including the years 1938 and 1939 which are involved in this proceeding. (R. 58, Stip. Par. 26; R. 118, Par. 19; R. 272, Ex. 15.)

The petitioner immediately conferred with the Commissioner's representatives about his rejection of the revised depreciation schedules and as soon as the Commissioner notified the petitioner that he would not change his position, the petitioner filed amended returns for the years 1932 to 1935 to report thereon

the proper depreciation as reflected in those schedules. (R. 66, Stip. Par. 32(h)(i).) The petitioner had always intended to file amended returns when and if necessary, but believed that it could reach an agreement with the Government agents as to an acceptable depreciation schedule in which event it thought the filing of amended returns would not be necessary. (R. 62, Stip. Par. 31c; R. 66, Stip. Par. 32(g) to (i).) The Commissioner of Internal Revenue refused to consider the amended returns for any purpose, treating them as though they had never been filed. (R. 37, Stip. Par. 25.)

After this case was tried but before it was decided by the District Court, the Commissioner through the Internal Revenue Agent in Charge at San Francisco, audited the amended returns for the years 1932 and 1933 and advised the petitioner by letter that they were correct. The petitioner, by motion, asked the District Court to admit this letter as evidence in the case (R. 69), but upon objection by the Commissioner that the audit and acceptance of the amended returns was a mistake and immaterial (R. 75), the District Court denied the petitioner's motion (R. 113) and its action was affirmed by the Circuit Court. (R. 301.)

The Courts below sustained the Commissioner's action in reducing the property cost by the excessive depreciation taken in the years 1932 to 1935, concluding that "the purpose of the amendment of the Revenue Act of 1932 (47 Stat. 169.201) was to foreclose or preclude a taxpayer who had made deductions in excess of the amount allowable from reducing the de-

preciation base by the lesser amount which was allowable" (R. 111) and that "disclosure of the excessive depreciation claimed and disallowance of its deduction by revenue agents or by the Commissioner does not authorize the latter to rectify the taxpayer's mistake or error of judgment. I am unable to perceive any basis for a different conclusion in this case from that enunciated in the Virginian Hotel Corporation case." (R. 112.)

It is petitioner's position that the facts in the *Virginian Hotel* case are different from the facts in this case and therefore the Virginian Hotel Corporation decision has but limited application to this case; that the above-quoted conclusions of the Courts below are not correct interpretations or applications of the Virginian Hotel Corporation decision; that the Courts below, in failing to give any significance to the statement of this Honorable Court in that decision that that case involved a situation where the depreciation had not been challenged by the Commissioner or his agents, have not given proper effect to that decision and have misconstrued and misapplied it in reaching their conclusions in this case, and have therefore rendered a decision which is probably in conflict with the Virginian Hotel Corporation decision; that by reason of their failure to give proper effect to this Honorable Court's decision in the *Virginian Hotel Corporation* case, the Courts below have given an erroneous construction to Section 113(b)(1)(B) of the Internal Revenue Code, and have so construed that section to give it a meaning which is contrary to law

and contrary to the intentions of Congress as to the meaning of that section.

The petitioner contends that in determining the basis for depreciation as of December 31, 1935 the cost of the property should not have been reduced for depreciation for the years 1932 to 1935 inclusive by any greater amount than the stipulated correct depreciation for those years which was charged off on the books of the Bank, accepted by the Government agents in their compilation of depreciation schedules, and reported on the amended returns for those years.

QUESTIONS PRESENTED.

1. Where the Commissioner of Internal Revenue has challenged a depreciation deduction taken by the taxpayer on an income tax return which disclosed a net loss in an amount greater than the depreciation deduction and as the result of that challenge, has discovered that the depreciation is wrong and excessive on the basis of facts known at the time the deduction was taken, can he allow such erroneous depreciation deduction and use it as a reduction of the taxpayer's basis for depreciation for later years under Section 113(b)(1)(B) of the Internal Revenue Code which requires that the basis shall be the cost of the property reduced by depreciation "to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws"? (The reduction of the basis for depreciation reduces the depreciation for later years.)

2. Does the Commissioner have any right to *allow* a deduction which he knows was erroneous on the basis of facts known at the time the deduction was taken, and which he knows is not authorized by the Revenue Statutes applicable to the year for which the deduction was taken, especially where the taxpayer had received no tax benefit from the deduction?

3. Where the Commissioner of Internal Revenue challenges a depreciation deduction taken on an income tax return which discloses a loss, and through his agents finds it to be erroneous, and not authorized by the Income Tax Statutes, and finds too that even if the deduction were disallowed there would be no taxable income or tax liability, and he thereupon does nothing more than accept the return, does his acceptance of the return under such circumstances constitute an allowance of the illegal depreciation deduction in fact or in law which under Section 113(b)(1)(B) of the Internal Revenue Code would have to be taken from the cost as depreciation "allowed" in determining the basis for depreciation for later years?

4. Where the Commissioner of Internal Revenue challenged a depreciation deduction taken on an income tax return showing a loss, and through his agents found the deduction to be illegal, but accepted the return merely because it was his practice to make no report of corrections where the corrections would not be sufficient to wipe out the loss and result in a tax liability, does the Commissioner have the right—

(1) to refuse to recognize or consider the amended return filed by the taxpayer which corrected the

original return to show the admittedly correct depreciation deduction,

(2) to ignore the taxpayer's requests that the depreciation be corrected and the taxpayer's representations that the depreciation deduction taken on the original return was erroneous and known to be erroneous at the time the deduction was taken,

(3) to refuse to correct the original deduction or to recognize that the taxpayer had effected the correction by calling the error to his attention and by filing amended returns, and

(4) to ignore the facts known to his agents and to ignore the corrected depreciation schedule submitted by his agents giving effect to the facts as known to them?

5. Did the Courts below err in answering the above questions in the affirmative, and were those Courts correct in concluding that these answers were required because of the decision of the U. S. Supreme Court in the case of *Virginian Hotel Corporation of Lynchburg v. Helvering,* 319 U. S. 523?

6. Did the Courts below err in concluding that the purpose of the amendment of Section 113(b)(1)(B) of the Revenue Act of 1932 "was to foreclose or preclude a taxpayer who had made deductions in excess of the amount allowable from reducing the depreciation base by the lesser amount allowable" in cases such as this where the deduction was not authorized by the statute applicable to the year for which the

deduction was taken based upon facts known at the time the deduction was taken.

7. Did the Courts below rule properly when they refused to permit introduction of evidence to the effect that the Commissioner's agents had examined the amended returns filed by the petitioner for the years 1932 and 1933 and had accepted them as correct?

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

1. In deciding that petitioner is entitled to a deduction for the years 1938 and 1939 for depreciation of furniture and fixtures only as allowed by the Commissioner of Internal Revenue in the amount of $380,762.15 and $419,718.48 respectively, instead of the higher amount claimed by petitioner in its complaint in this proceeding.

2. In its conclusion of law sustaining the Commissioner of Internal Revenue in reducing petitioner's cost of its furniture and fixtures by admittedly excessive depreciation for the years 1932 to 1935 inclusive, to determine the basis for computing the depreciation deduction for later years.

3. In deciding as a matter of law that the Commissioner "allowed" the depreciation deducted by the petitioner on its original return for the years 1932-1935, within the meaning of the term "allowed" as used in Section 113(b)(1)(B) of the Internal Revenue Code.

4. In deciding as a matter of law that "disclosure of the excessive depreciation claimed and disallowance of its deduction by revenue agents or by the Commissioner does not authorize the latter to rectify the taxpayer's mistake or error of judgment."

5. In deciding as a matter of law that there is no basis for a different conclusion in this case than the conclusion reached by the U. S. Supreme Court in the case of *Virginian Hotel Corporation of Lynchburg v. Helvering*, 319 U. S. 523.

6. In *failing to decide* as a matter of law—

(a) that the Commissioner of Internal Revenue was bound to accept the determination of his agents as to the correct depreciation allowance for the years 1932 to 1935, and

(b) that the Commissioner of Internal Revenue could not reject the determination and allowance made by his agents, and could not in lieu thereof make a determination "allowing" a depreciation deduction for those years not authorized by the income tax statutes applicable to those years.

7. In failing to conclude that under the circumstances of the case the Commissioner had no authority to allow a depreciation deduction for the years 1932 to 1935 in excess of the amount allowable under the income tax statutes applicable to those years; and in failing to conclude, too, that when the Commissioner after challenging the deduction, found that it was not within the statutory provision authorizing such a de-

duction but did nothing about it because no tax liability was involved, the deduction must be considered as having been disallowed rather than allowed.

8. In failing to decide as a matter of law that the correct basis for depreciation of furniture and fixtures as of December 31, 1935, is the cost of said furniture and fixtures reduced by the stipulated correct depreciation allowable for the years 1932 to 1935 rather than the cost reduced by the erroneous depreciation deducted on the original income tax returns for those years.

9. In failing to decide as a matter of law that the petitioner corrected its erroneous returns for 1932 to 1935 by requesting the Commissioner and his agents to correct the depreciation taken as a deduction thereon, and by the filing of amended returns for those years which did report the correct depreciation deduction.

10. In sustaining the District Court in denying petitioner's motion to reopen the case to introduce evidence of the fact that after the filing of the stipulation of facts, the Commissioner of Internal Revenue through his agents did consider the amended returns filed by the petitioner for the years 1932 to 1935 inclusive and accepted them as correct.

11. In failing to reverse the judgment of the District Court.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

I. THE CIRCUIT COURT OF APPEALS HAS DECIDED IMPORTANT QUESTIONS OF FEDERAL LAW IN A WAY PROBABLY IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

A. *Conflict with Virginian Hotel Corp. of Lynchburg v. Helvering,* 319 U. S. 523.

In construing the *Virginian Hotel Corporation* case to mean that the Commissioner may accept a return and thus allow the depreciation deduction taken on that return even though he knew at the time he accepted the return that the deduction was wrong and illegal on the basis of facts known at the time the return was filed, the Courts below have so misconstrued and misapplied the decision of this Honorable Court in the *Virginian Hotel Corporation* case that their decision is probably in conflict with the *Virginian Hotel Corporation* decision, because:

(a) The *Virginian Hotel Corporation* case involved only the question of whether a depreciation deduction may be allowed if it did not result in a tax benefit, and this Honorable Court held that the matter of tax benefit was immaterial to the question of whether a deduction had been allowed, and this point is conceded in this case. This Honorable Court did not consider or decide the question of whether the Commissioner has the right to deliberately allow an illegal deduction, which is the question involved in this case, so the Courts below were wrong in concluding that the Commissioner's authority to make

such an allowance was confirmed by the *Virginian Hotel Corporation* decision.

(b) This Honorable Court in its decision in the *Virginian Hotel Corporation* case emphasized that the depreciation deduction which was held to have been allowed, *had never been challenged* by the Commissioner or his agents. The Courts below considered the case to be applicable even though the deduction was challenged by the Commissioner and his agents and found to be illegal on the basis of facts known at the time the deduction was taken. This is an unwarranted extension of the *Virginian Hotel Corporation* decision because:

(1) such an interpretation of the decision brings it into direct conflict with decisions of this Honorable Court in the case of *New Colonial Ice Co. v. Helvering* (1934), 292 U. S. 435, 54 S. Ct. 788, and *Manhattan General Equipment Co. v. Commissioner* (1936), 297 U. S. 129, 56 S. Ct. 397, holding that no deduction can be allowed unless it is authorized by the statute and the Commissioner has no discretion or authority to allow an illegal deduction;

(2) such an interpretation of the decision brings it into direct conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case of *Commissioner v. Mutual Fertilizer Co.* (1947) 159 Fed. (2d) 470, and the decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Commissioner v. Cleveland Adolph Mayer Realty Corp.* (1947), 160 Fed. (2d) 1012, holding that depreciation

is to be determined upon the basis of facts known at the time the deduction is taken.

(c) The Courts below erred in holding that this Honorable Court decided in the *Virginian Hotel Corporation* case that the taxpayer is foreclosed or precluded from correcting an erroneous depreciation deduction, and that even the Commissioner has no authority to correct the error, because:

(1) in our opinion, this Honorable Court did not so decide, and

(2) such a decision would be contrary to the Commissioner's statutory authority to correct any mistake, and to a common sense view that any taxpayer should have the right to voluntarily correct any mistake so long as he does not derive any unfair advantage thereby.

B. *Conflict with New Colonial Ice Co. v. Helvering,* 292 U. S. 435 and *Manhattan General Equipment Co. v. Commissioner,* 297 U. S. 129.

The decision of the Courts below to the effect that the Commissioner can allow an illegal deduction after discovering its illegality in the course of an audit of the return is in conflict with the decisions of this Honorable Court in the case of *New Colonial Ice Co. v. Helvering* (1934), 292 U. S. 435, 54 Sup. Ct. 788, holding that

> "Whether and to what extent deductions shall be allowed depends upon legislative grace, and only as there is clear provision therefor can any particular deduction be allowed."

and in the case of *Manhattan General Equipment Co. v. Commissioner* (1936), 297 U. S. 129, 56 S. Ct. 397, holding in effect that the Commissioner cannot make an allowance by regulation not permitted by the statute.

II. THE CIRCUIT COURT OF APPEALS HAS RENDERED A DECISION IN CONFLICT WITH DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS.

A. The decision of the Court below that the Commissioner can allow a depreciation deduction which was erroneous on the basis of facts known at the time the deduction was taken, is in direct conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case of *Commissioner v. Mutual Fertiliser Co.* (1947), 159 F. (2d) 470, and the decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Commissioner v. Cleveland Adolph Mayer Realty Corp.* (1947), 160 F. (2d) 1012.

III. THE CIRCUIT COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN BUT SHOULD BE SETTLED BY THIS COURT.

A. *May the Commissioner deliberately allow a depreciation deduction which he knows to be illegal?*

The Courts below held that the Commissioner can challenge a depreciation deduction, find it to be illegal, and yet allow it; also, that neither the taxpayer nor the Commissioner can correct the illegal

deduction. These are important matters of Federal law and especially so since, in our opinion, this holding is contrary to the intention of Congress at the time of the amendment of Section 113(b)(1)(B) in the Revenue Act of 1932 (47 Stats. 169.201), that retroactive corrections should be made. The Senate Finance Committee in its report on the amendment (Senate Report No. 665, 72d Congress, 1st Session, p. 29) stated:

> "Your Committee has not thought it necessary to include any express provision against retroactive adjustments of depreciation on the part of the Treasury as the regulations of the Treasury seem adequate to protect the interests of the taxpayer in such cases. These regulations require the depreciation allowances to be made from year to year in accordance with the then known facts and do not permit a retroactive change in these allowances by reason of the facts developed or ascertained after the years for which such allowances are made."

B. *May the taxpayer correct a mistake by filing amended returns?*

The Courts below held that the taxpayer could not even correct its own mistake by the filing of amended returns after the Commissioner had refused to correct the error or to permit his agents to correct the error. This is an important matter of Federal law which we believe should be settled by this Honorable Court because:

(a) If a taxpayer does not have a right to file an amended return to correct an error, there is no

medium available to the taxpayer to correct a mistake if the Commissioner refuses to correct it, in cases where the correction cannot be the subject of a claim for refund of overpaid tax.

(b) The decision is in conflict with the decision of the U. S. District Court for the District of Connecticut, in the case of *Milford Trust Co. v. U. S.* (1945), 63 Fed. Supp. 618, which appears to us to take a much more sensible view of the right of a taxpayer to file amended returns to correct mistakes.

WHEREFORE it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Ninth Circuit should be granted.

Dated, San Francisco, California,
July 30, 1948.

GEORGE H. KOSTER,
Attorney for Petitioner.

CERTIFICATE OF COUNSEL.

The foregoing petition for writ of certiorari, together with the hereinafter contained supporting brief, is in the opinion of the undersigned attorney for petitioner well founded in point of fact and law, is presented in good faith and is not interposed for delay.

Dated, San Francisco, California,
July 30, 1948.

GEORGE H. KOSTER,
Attorney for Petitioner.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1948

No.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION (a national banking association),
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Ninth Circuit sought to be reviewed was entered June 8, 1948, affirming the judgment of the United States District Court for the Northern District of California, Southern Division, which was entered March 14, 1947.

The jurisdiction of this Honorable Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U.S.C.A. Section 347.

OPINIONS BELOW.

The *per curiam* decision of the Circuit Court of Appeals (R. 300), reported in 168 Fed. (2d) ....., reads as follows:

> "The judgment of the District Court is affirmed for the reasons stated in its opinion and on authority of Virginian Hotel Corporation v. Helvering (4 Cir.) 132 F. 2d 909, affirmed 319 U. S. 523."

The decision of the Circuit Court of Appeals was rendered and filed on June 8, 1948, and the judgment of that Court was entered on the same day. (R. 301.)

The District Court opinion and decision, reported in 69 Fed. Supp. 932, is set forth in the transcript of record herein, pages 106-112. The District Court judgment was entered March 14, 1947. (R. 131.)

STATEMENT OF FACTS.

A concise statement of the nature of the case has been given under the heading "Statement" in the Petition for Certiorari. However, an explanation of the two stipulations of facts filed in the District Court, and a statement of facts in somewhat further detail than contained in the Petition for Certiorari, may be helpful to the Court in its consideration of this case.

Stipulation No. 1 (R. 28-38) is devoted primarily to a statement of the procedure followed by the offices of the Commissioner of Internal Revenue in the handling and audit of a tax return; of the extensive delegations of authority to the field agents under the decentralization method for audit of returns; of the practice followed in the audit of returns showing net losses; of the practice of reopening closed returns; of certain procedure followed in the audit of petitioner's original tax returns for the years 1932 and 1936 inclusive; of the action of the Bureau of Internal Revenue rejecting the revised depreciation schedule prepared by its own agents and the petitioner; and of the bureau refusal up to that time to consider the amended returns filed by petitioner for the years 1932 to 1935 inclusive.

Stipulation No. 2 (R. 38-68) contains a statement of the jurisdictional facts such as the filing of the returns, payment of the tax, filing of the refund claims, rejection of the claims, etc.; of the depreciation deductions reported on the respective returns for the years 1930 to 1939 inclusive and the adjustments made thereto by the Commissioner for the years 1938 and 1939; of the method employed by petitioner in computing the depreciation for accounting purposes prior to 1932, and for 1932 and subsequent years; of the mistake in the reporting of the depreciation on the original tax returns for the years 1932 to 1935 inclusive and reasons therefor and the efforts made by petitioner to correct this mistake; of the audit of the returns and the action taken by the agents fol-

lowing the prescribed procedure as outlined in Stipulation No. 1; of the challenge of the depreciation deduction by the revenue agents; of the extensive work and expense involved in the compilation of the revised depreciation schedule by the revenue agents and the petitioner (Exhibit 16 of the stipulation (R. 273-274) containing two of 80 similar schedules (R. 293) is a copy of those schedules on buildings alone, and Exhibit 3 (R. 151 to 196) contains the engineer revenue agent's report of his work and the problems involved in the preparation of the revised schedules); of the fact that the depreciation taken by petitioner on its books was the correct and allowable depreciation for the years 1932 to 1935 inclusive and the revised depreciation schedules reflect that depreciation as the correct depreciation; and of the fact that petitioner filed amended returns for the years 1932 to 1935 reporting thereon the correct depreciation allowable for those years, and that up to the time the stipulations were filed the Commissioner had not considered the amended tax returns for any purpose.

The facts as recited in these stipulations are:

Prior to January 1, 1932 the annual depreciation computed by the petitioner bank for income tax purposes was exactly the same as the depreciation computed for bookkeeping purposes. (R. 119, Par 20; R. 48, Stip. Par. 16.)[2]

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[2]In 1930 and 1931 the Bank reported large net losses on its tax returns and deducted substantial amounts on those returns for depreciation. (R. 44, Stip. Par. 12.) However, there is nothing to indicate that the depreciation deducted in those years was not considered fair and reasonable on the basis of the conditions and facts

In 1931 and 1932 the Bank inspected and surveyed all of its properties and made a revised estimate of the condition of those properties and of their useful lives; and on the basis of that estimate it determined that the depreciation schedules then being used were incorrect. It then compiled a new schedule for the computation of the depreciation, and commencing January 1, 1932, this new schedule was used for determining the depreciation which was written off on the books of the Bank for the years 1932 to 1939 inclusive (R. 119, Par 20; R. 57, Stip. Par. 25); *and it is stipulated in effect that the depreciation on furniture and fixtures computed under this schedule for the years 1932 to 1935 was the correct depreciation allowable as a deduction under the applicable income tax statutes in those years* (R. 126, Par. 35; R. 55, Stip. Par. 22c; R. 58, Stip. Par. 26a), and the depreciation on banking premises computed under this schedule was actually a bit less than the amount allowable for the years 1932 to 1935. (R. 58, Stip. Par. 26b.)

The tax department of the Bank in preparing the income tax returns for the years 1932 to 1937 inclusive ignored the revised depreciation schedule for

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known at that time, although on the basis of facts subsequently developed the depreciation was excessive. The Bank acknowledges and has acknowledged throughout this proceeding, that the *allowable* depreciation is the depreciation computed on the facts known at the time the deduction is taken and so has made no claim in this proceeding that there should be any restoration to the basis of its property, of any depreciation deducted in the years 1930 and 1931 even though no tax benefit was obtained from those deductions. (*Commissioner v. Mutual Fertilizer Co.* (C.C.A.-5, 1947), 159 F. (2d) 470; *Commissioner v. Cleveland Adolph Mayer Realty Corp.* (C.C.A.-6, 1947), 160 F. (2d) 1012.)

various practical reasons stated in the stipulation in this case (R. 60, Stip. Par. 31, 32), and continued to report as the depreciation deduction the depreciation computed on the schedule used by the Bank prior to 1932 (R. 119, Par. 20) though fully cognizant that the depreciation deduction so computed was incorrect. (R. 62, Stip. Par. 31c.) The official of the Bank responsible for the Bank's income tax return did not know that this practice was being followed until 1938. (R. 67, Stip. Par. 33.) In 1938 and 1939, the tax years involved in this proceeding, the practice of continuing the obsolete and incorrect depreciation schedules was stopped (R. 62, Stip. Par. 31(d) (e)) and the income tax returns for those years reflect as deductions the depreciation as computed under the said correct schedule being used by the Bank for bookkeeping purposes. (R. 119, Par. 20; R. 63, Stip. Par. 31e.)

The Bank had net losses for income tax purposes for each of the years 1932 to 1935 inclusive in excess of the entire amount of depreciation deducted in the respective year, so obtained no tax benefit whatever from the depreciation deduction or any part of it. (R. 120, Par. 21a; R. 44, Stip. Par. 12, 13.) Since the depreciation deducted each year (approximately 170% of book (correct) depreciation) was substantially in excess of the depreciation taken on the Bank's books, the excess had to be and was disclosed on a reconciliation schedule on the tax return for each of those years (R. 124, Par. 29; R. 60, Stip. Par. 30), so the Commissioner was on notice that there was this substantial difference between the depreciation deducted in each

of those years and the depreciation charged off by the Bank on its books in those respective years. (R. 60, Stip. Par. 30.)

The returns and books for each of the years 1932 to 1935 were audited by Internal Revenue agents. (R. 120, Par. 21b; R. 33, Stip. Par. 16 to 21.) The audit of the returns by the expert Internal Revenue auditors or agents was a challenge of every item of deduction on the return since no deduction is allowable unless authorized by statute and the burden is on the taxpayer to establish the correctness of the deductions. The agents, though recognizing the depreciation to be wrong, failed or refused to prepare or aid in the preparation of a revised depreciation schedule because, under established bureau procedure, they were not allowed to compile or aid in the compilation of revised depreciation schedules where any adjustment which might result therefrom would not result in a tax liability. (R. 121, Par. 21(c)); R. 50, Stip. Par. 19.) In accordance with Bureau of Internal Revenue procedure, after the agents progressed far enough in their audits to be satisfied that there would not be sufficient corrections to result in a tax liability, they so reported to their superiors who transmitted their reports and the tax returns to the bureau. (R. 30, Stip. Par. 6.) The bureau upon receipt of the case, reviewed it, approved it, and sent it to the closed file. (R. 121, Par. 21d.) The petitioner was not furnished with a copy of the agents' reports. (R. 30, Stip. Par. 6.)

In the course of the audit of the returns for the years 1937, 1938 and 1939 tax liabilities were involved

so the matter of the revision of the depreciation schedules and the correction of the depreciation deduction for the years 1932 to 1939 was given careful attention by the Internal Revenue Agents (R. 53, Stip. Par. 22; R. 35, Stip. Par. 22, 23) and revised depreciation schedules were prepared (R. 144, Ex. 3 at R. 151 to 192; and Ex. 16, R. 273 and 274, which are but two of 80 schedules as stipulated, R. 294).

The preparation of these revised depreciation schedules for approximately 500 buildings and the furniture and fixtures contained therein was a tremendous job extending from December, 1939 to November 1941; and under the direction of Internal Revenue Agents the Bank employed an independent appraisal and engineering company to report upon factors required for use in the schedule, and employed a special staff of men to work on the compilation of the schedule. (R. 53, Stip. Par. 22.) The record shows that it was because of the full appreciation of the intricate nature of this job, that the Bank's tax department employees and representatives did not undertake the revision of the schedules until they could have the opportunity to do so in conjunction with the cooperation of the government agents. (R. 63, Stip. 31e; R. 66, Stip. Par. 32g.)

The revised schedules were so constructed that the remaining cost of the property (cost less depreciation) as of December 31, 1935, was first computed, and the annual depreciation thereon was the prorata of that remaining cost spread over the estimated remaining useful life of the property; and in the re-

sultant revised schedules the Bank's consistent contention that the depreciation was wrong ever since January 1, 1932 and should be corrected in determining the correct remaining cost as of December 31, 1935, was recognized and the remaining cost as of December 31, 1935 was computed by deducting from the cost only the correct (or allowable) depreciation for the years 1932 to 1935. (R. 124, Par. 32; R. 54, Stip. Par. 22(b)(c)(d).) The revised schedules were mutually acceptable to the Bank and the Internal Revenue agents. (R. 36, Stip. Par. 23; R. 54, Stip. Par. 22b.)

When the revised depreciation schedules were referred to the Commissioner of Internal Revenue (Bureau of Internal Revenue, Washington, D. C.) in November, 1941, the bureau rejected them on the ground that the tax returns for the years 1932 to 1935 had been "accepted" and therefore the depreciation deducted thereon was "allowed" and had to be deducted from the cost of the property to determine the basis for depreciation regardless of whether the depreciation deducted on the return was right or wrong and regardless of whether the bureau knew that the deduction was wrong. (R. 125, Par. 32; R. 36, Stip. Par. 23, 24.) The revised schedules were thereupon discarded by the bureau and the depreciation was recomputed on the basis of cost as of December 31, 1935 reduced by the excessive depreciation deducted on the tax returns for 1932 to 1935. (R. 125, Par. 32; R. 56, Stip. Par. 22f; R. 193.) The remaining cost as computed by the bureau on furniture and fixtures was approximately $1,400,000 less than was computed in

the revised depreciation schedule and on banking premises was approximately $600,000 less than was computed in the revised depreciation schedule (R. 118, Par. 19; R. 183), so the bureau action in effect wiped out approximately $2,000,000 of capital investment which on the basis of the revised depreciation schedules which had been prepared by the Bank and the Revenue Agents would have been returned to the Bank through depreciation deductions in years following 1935.

The record shows that on December 10, 1941 (before the case of the *Virginian Hotel Corporation of Lynchburg* started on its course of litigation) the taxpayer presented in writing to the Commissioner of Internal Revenue a statement of the facts as herein presented and urged the acceptance of the revised schedules (R. 275) and from then until 1945 representatives of the Bank held a number of conferences with the representatives of the bureau in an effort to secure acceptance of the schedules. (R. 66, Stip. Par. 32h.) Although the Bank had at all times been considering the filing of amended returns for 1932 to 1935 its representatives felt confident that mutually acceptable depreciation schedules could be worked out and that the filing of amended returns would thus be rendered unnecessary. (R. 62, Stip. Par. 31c; R. 66, Stip. Par. 32h.) However, when in 1945 the Bureau of Internal Revenue finally concluded conferences with the Bank's representatives by refusing to accept the revised depreciation schedules even though acknowledging that those schedules reflected the correct depreciation for

the years 1932 to 1935, the Bank filed amended returns for the years 1932 to 1935 reporting thereon the correct deduction for depreciation for the respective years as reflected in the said revised depreciation schedules. (R. 67, Stip. Par. 32i.) The correction of the depreciation did not overcome the net losses for those years so the amended returns showed no tax liability. (R. 232, 239, 260, 266.) The government was not deprived of any tax by reason of the corrections.

The Bureau of Internal Revenue refused to consider the amended returns for any purpose up to the time the stipulations filed in this proceeding were signed. (R. 127, Par. 39; R. 37, Stip. Par. 25.) However, after this case was submitted to the District Court the Bank received a letter from the Internal Revenue Agent in Charge advising it that the amended returns for 1932 and 1933 were accepted as correct; and petitioner Bank filed a motion in the District Court to reopen the case to receive this letter in evidence and the government opposed the motion by contending that the examination and acceptance of the amended return was all a mistake and was immaterial. (R. 69-105.) The District Court denied the motion and the Circuit Court did not disturb the District Court's action. (R. 113, 138, Par. 10; R. 291; R. 300.)

The District Court decided against the taxpayer holding that in determining the basis for depreciation for later years under Section 113(b)(1)(B) of the Internal Revenue Code the Commissioner properly reduced the cost of the property by the erro-

neous depreciation taken on the original returns for the years 1932 to 1935, and in its opinion the Court stated: "The purpose of the amendment of the Revenue Act of 1932 (47 Stat. 16[9].201) was to foreclose or preclude a taxpayer who had made deductions in excess of the amount allowable from reducing the depreciation base by the lesser amount which was allowable" (R. 111) and "Disclosure of the excessive depreciation claimed and disallowance of its deduction by revenue agents or by the Commissioner does not authorize the latter to rectify the taxpayer's mistake or error of judgment. I am unable to perceive any basis for a different conclusion in this case from that enunciated in the *Virginian Hotel Corporation* case". (R. 112.) The District Court's views and decision were affirmed by the Circuit Court of Appeals. (R. 300.)

STATUTES AND REGULATIONS INVOLVED.

See appendix hereto.

QUESTIONS PRESENTED AND SPECIFICATION OF ERRORS TO BE URGED.

The questions presented, and the specification of errors to be urged, are set forth in full in the petition for certiorari, and in the interest of brevity are not repeated here.

ARGUMENT.

The petitioner raises no objection to the Government's method of computing depreciation by taking the unexhausted cost of the property at the beginning of the taxable year and spreading it over an estimated useful life from the beginning of the year.

The petitioner concedes that the statute requires that the cost basis for depreciation must be reduced by not less than the allowable depreciation for prior years regardless of whether tax benefit was derived therefrom.

The petitioner concedes that the cost basis for depreciation must be reduced by the depreciation allowed in prior years even though in excess of the amount allowable *if* that depreciation was actually and legally allowed under the income tax laws applicable to that year, or *if* a tax benefit had been derived therefrom (estoppel).

The petitioner concedes that the mere fact that it did not obtain a tax benefit from the excessive depreciation deducted by it on its original tax returns for the years 1932 to 1935 inclusive, does not *in itself* justify a conclusion that the erroneous depreciation could not have been "allowed". (*Virginian Hotel Corporation decision.*) However, the fact that the excessive deduction did not result in a tax benefit, *coupled* with the fact that the Commissioner knew that the deduction was excessive and that he and his agents challenged it and his agents corrected it, does justify the conclusion that the excessive depreciation

was not allowed and could not have been allowed legally.

The matter to be argued is confined by reason of these concessions to whether the excessive depreciation reported by the petitioner on its original income tax returns for the years 1932 to 1935, inclusive, was "allowed under this chapter or prior income tax laws" within the meaning of that phrase as used in the statute (Section 113(b)(1)(B)).

Petitioner's argument is:

I.

THE VIRGINIAN HOTEL CORPORATION DECISION DOES NOT APPLY WHERE THE EXCESSIVE DEPRECIATION WAS CHALLENGED BY THE COMMISSIONER OR HIS AGENTS AND FOUND TO BE ERRONEOUS ON THE BASIS OF FACTS KNOWN AT THE TIME THE DEDUCTION WAS TAKEN. THE DECISION OF THE COURTS BELOW THAT THE VIRGINIAN HOTEL CORPORATION CASE WAS APPLICABLE IS AN ERRONEOUS INTERPRETATION OF THAT CASE.

The record shows that the tax returns for 1932 to 1935 were assigned to field agents of the Commissioner of Internal Revenue for examination and audit. This in itself might be said to be a challenge of the returns and the items claimed as deductions thereon. Also, the record shows that the depreciation deducted on the original returns for the years 1932 to 1935 was excessive and was reported by mistake and the agents of the Commissioner did challenge and did correct it. These facts distinguish this case from the *Virginian Hotel Corporation* case and preclude a determination that the erroneous depreciation was "allowed under this chapter or prior income tax laws" within the

meaning of that term as used in Section 113(b)(1)(B).

The only point decided by this Honorable Court in the *Virginian Hotel Corporation* case was that a depreciation deduction may have been allowed even though no tax benefit was derived therefrom.

This Court made the following statement in its decision in the *Virginian Hotel Corporation* case:

> "'Allowed' connotes a grant. Under our federal tax system there is no machinery for formal allowances of deductions from gross income. Deductions stand if the Commissioner takes no steps to challenge them. Income tax returns entail numerous deductions. If the deductions are not challenged, they certainly are 'allowed' since tax liability is then determined on the basis of the returns. Apart from contested cases, that is indeed the only way in which deductions are 'allowed'. And when all deductions are treated alike by the taxpayer and by the Commissioner, it is difficult to see why some items may be said to be 'allowed' and others not 'allowed'. It would take clear and compelling indications for us to conclude that 'allowed' as used in Section 113(b)(1)(B) means something different than it does in the general setting of the revenue acts."

The Commissioner apparently construes this decision as *requiring* him to assert against the petitioner that by accepting a return, the depreciation deduction taken thereon is conclusively allowed whether or not he was fully aware that the deduction was excessive and illegal. However, the Commissioner must believe

that the *Virginian Hotel Corporation* case does not apply and the deduction is not conclusive in cases where an adjustment of the depreciation will result in a tax, because he takes the position that if he has any cause to reopen the return to make any adjustment which might result in a tax, he is not bound by the inferred allowance of the deductions from the previous acceptance of the return, and may disallow the excessive depreciation and thus increase the tax.[3]

He does not seem at all disturbed by the inconsistency between his position that he need not treat the deduction as having been allowed if he can levy a tax thereby, and his position that he must treat the deduction as having been conclusively allowed if he can impose a greater tax upon the taxpayer thereby.

The Court below, too, in sustaining the Commissioner, construed the *Virginian Hotel Corporation* decision as holding that the acceptance of a return is conclusive against the taxpayer. The Courts below seemed to think that even the Commissioner was foreclosed from correcting the erroneous deduction. They concluded:

> "The purpose of the amendment of the Revenue Act of 1932 (47 Stat. 169.201) was to foreclose or preclude a taxpayer who had made deductions in excess of the amount allowable from reducing the depreciation base by the lesser amount which was allowable." (R. 111.)

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[3]R. 30, Stip. Par. 6a; this actually happened in this case when the agents of the Commissioner reopened the year 1936 return after it had been "accepted". Also I.T. 2944, Treas. Dept. Cum. Bul. XIV-2, 1935, p. 126.

"Disclosure of the excessive depreciation claimed and disallowance of its deduction by Revenue Agents or by the Commissioner does not authorize the latter to rectify the taxpayer's mistake or error of judgment. I am unable to perceive any basis for a different conclusion in this case from that enunciated in the *Virginian Hotel Corporation* case, infra." (R. 112.)

We respectfully submit that this conclusion is induced by a misconstruction of the *Virginian Hotel Corporation* decision and is not in accord with the pertinent income tax laws which prescribe the type and amount of deductions *which may be taken or allowed* on an income tax return.

Both the Commissioner and the Courts below give no significance to the reference several times made by this Honorable Court in the *Virginian Hotel Corporation* decision to the lack of challenge by the Commissioner or his agents, of the claimed deduction. At the very beginning of its opinion this Court stated "No objection was taken by the Commissioner or his agents to the amounts claimed and deducted." In the portion of the Court's opinion hereinbefore quoted (supra, p. 39) appear the statements—"deductions stand if the Commissioner takes no steps to challenge them," and "if the deductions are not challenged; they certainly are 'allowed' * * *." The Commissioner and the Courts below extend the decision as though this Court intended it to apply whether or not the deductions had been challenged. It is respectfully submitted that since this Court deemed it important to specifically qualify its decision by limiting it to instances where

the claimed deductions had not been challenged by the Commissioner, the decision is inapplicable to a case, such as the instant case, where the claimed deductions were challenged. The decision is absolutely silent as to the status of an erroneous deduction once it has been challenged. The limited nature of the issue and the limited record before this Court precluded any consideration of the answer in such a situation.

We believe the *Virginian Hotel Corporation* decision stands only for the proposition that the mere fact that the excessive depreciation deducted in the prior years did not result in tax benefit, does not mean that the deduction was not allowed. But the answer to the question in this proceeding of whether the challenged excessive depreciation deduction was allowed, and whether the excessive deduction could be corrected, must be determined from all the facts in the case and the applicable statutory provisions independent of this Court's decision in the *Virginian Hotel Corporation* case which we believe does not apply where the prior year depreciation was challenged by the Commissioner or his agents.

II.

THE LEGISLATURE INTENDED THAT RETROACTIVE ADJUSTMENTS OF ERRONEOUS DEDUCTIONS FOR DEPRECIATION SHOULD BE MADE WHERE NECESSARY TO PROTECT THE INTEREST OF THE TAXPAYER. THE COURTS BELOW ERRED IN HOLDING THAT NO CORRECTION OF THE ORIGINAL DEDUCTION WAS PERMISSIBLE UNDER THE STATUTE.

The action of the Commissioner sustained by the Courts below, in wiping out approximately $2,000,000 of petitioner's capital investment which it is conceded would have been returnable to the petitioner through depreciation allowances in years after 1935 had the depreciation been correctly computed on the original tax returns for the years 1932 to 1935, is inequitable and unjust, and therefore in conflict with Section 113(b)(1)(B) and with the legislative intent that Section 113(b)(1)(B) be so administered as to accomplish equitable results.

The Revenue Act of 1928, Section 111(b)(2) provided that in determining the basis for depreciation the cost of the property should be reduced by the depreciation previously *allowable*. At the request of the Treasury, this section was amended by the Revenue Act of 1932 (Section 113(b)(1)(B)) to provide that the cost should be reduced by the depreciation previously "allowed (but not less than the amount allowable) under this chapter or prior income tax laws", the reason for the amendment being stated by the committee reports[4] as follows:

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[4]Report No. 708 of the Committee on Ways and Means, 72nd Congress, 1st Session, page 22, repeated in Senate Report No. 665, same session.

"In subparagraph (B), relating to depreciation, etc. for the period since February 28, 1913, the bill requires that adjustment be made to the extent allowed (but not less than the amount allowable) instead of by the amount * * * allowable as in the prior act. The Treasury has frequently encountered cases where a taxpayer, who has taken and been allowed depreciation deductions at a certain rate consistently over a period of years, later finds it to his advantage to claim that the allowances so made to him were excessive and that the amounts which were in fact allowable were much less. By this time the Government may be barred from collecting the additional taxes which would be due for the prior years upon the strength of the taxpayer's present contentions. The Treasury is obliged to rely very largely upon the good faith and judgment of the taxpayer in the determination of the allowances for depreciation, since these are primarily matters of judgment and are governed by facts particularly within the knowledge of the taxpayer, and the Treasury should not be penalized for having approved the taxpayer's deductions. While the committee does not regard the existing law as countenancing any such inequitable results, it believes the new bill should specifically preclude any such possibility."

The Senate Finance Committee in its report added the following very enlightening statements:

"Your committee has not thought it necessary to include any express provision against retroactive adjustments of depreciation on the part of the Treasury as the regulations of the Treasury seem adequate to protect the interests of taxpayer

in such cases. These regulations require the depreciation allowances to be made from year to year in accordance with the then known facts and do not permit a retroactive change in these allowances by reason of the facts developed or ascertained after the years for which such allowances are made.'"[5]

It seems obvious that the Legislature though prohibiting a retroactive adjustment of depreciation in order to protect the Government against inequitable claims, intended specifically to recognize the right to make a retroactive adjustment where such an adjustment was required to "protect the interests of the taxpayer". Since the Legislature expressly stated it was not making provision against retroactive adjustments it certainly did not intend that the law should be so administered that the Commissioner could refuse to make a retroactive adjustment to the prejudice of the taxpayer or that the Commissioner could conclusively bind the taxpayer to an error. *The Legislature seemed satisfied with the existing Act requiring an adjustment of cost for "allowable" depreciation excepting only in those instances where to ignore the amount of depreciation actually allowed would result in the inequity described in the committee reports.*

The conclusion of the Commissioner and the Courts below to the effect that the erroneous depreciation deduction taken on the original returns for 1932 to 1935 is conclusive and that no retroactive correction

[5]Treasury Regulations 74, Articles 205 and 561 (substantially similar to Articles 23(l)5 and 113(b)1, Appendix hereto.

thereof may be made is in conflict with the expressed intentions of the Legislature that retroactive adjustments may be made if necessary to protect the interests of the taxpayer, for which reason no expressed prohibition against retroactive adjustments was inserted in Section 113(b)(1)(B).

The Virginian Hotel Corporation involved a case where retroactive adjustment would not have been permitted even under the revenue acts prior to the Revenue Act of 1932 because the change in the depreciation rate was due to facts developed or ascertained after the years for which the allowances were made, so it was not necessary for this Court to decide whether a retroactive adjustment was prohibited under any circumstance, or whether it could be made under the circumstances referred to in the Senate Finance Committee report. In the instant case the deduction was conceded to be wrong on the basis of facts known at the time the deduction was taken so, we respectfully submit, a retroactive correction was permissible under Section 113(b)(1)(B) under the intendment of Congress as to the manner in which the section should be administered.

III.

THE COMMISSIONER HAD NO AUTHORITY TO DELIBERATELY OR CONSTRUCTIVELY ALLOW A DEDUCTION KNOWN TO HIM TO BE ERRONEOUS AND NOT AUTHORIZED BY THE STATUTE APPLICABLE TO THE YEAR IN WHICH THE DEDUCTION WAS TAKEN. THE DECISION OF THE COURTS BELOW THAT THE COMMISSIONER COULD ALLOW SUCH AN ILLEGAL DEDUCTION IS CONTRARY TO DECISIONS OF THIS HONORABLE COURT AND OF THE COURTS OF APPEALS OF OTHER CIRCUITS.

The Commissioner had no authority to "allow" the excessive depreciation deducted by petitioner on its original 1932 to 1935 tax returns, because the amounts deducted were admittedly not authorized by the income tax laws (Section 23(k) of the Revenue Act of 1932, and 23(l) of the Revenue Act of 1934)* applicable to those years; and when the Commissioner and his agents who challenged the deduction were on notice that the deduction did not comply with the income tax law and was not allowable thereunder, they had no power or authority to "allow" the erroneous deduction especially when the petitioner had obtained no tax benefit from the erroneous deduction and could not therefore be estopped from demanding a correction of the erroneous deduction. (*New Colonial Ice Co. v. Helvering* (1934), 292 U. S. 435, 54 S. Ct. 788; *Manhattan General Equipment Co. v. Commissioner* (1936), 297 U. S. 129, 56 S. Ct. 397; *Jefferson and Clearfield Coal and Iron Co. v. U. S.* (1936), Ct. Cl. 14 Fed. Supp. 918.)

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*Similar to Section 23(l) of the Internal Revenue Code, Appendix hereto.

Although the Commissioner may not be bound by unaccepted conclusions of his agents, he is bound by their knowledge of the facts and cannot make a determination contrary to those facts. In this case the agents knew that as a matter of fact the depreciation deducted on the original returns for the years 1932 to 1935 was excessive and unreasonable on the basis of facts known at the time the deduction was taken, and therefore *not* allowable under the income tax statutes applicable to those years, so the Commissioner could not reject these facts and make a determination in conflict therewith and in conflict with the statute authorizing the depreciation deduction. (*Commissioner v. Cleveland Adolph Mayer Realty Corp.*, CCA-6-1947, 160 F. (2d) 1012; *Commissioner v. Mutual Fertilizer Co.*, CCA-5-1947, 159 F. (2d) 470; *Commissioner v. Van Vorst*, CCA-9-1932, 59 F. (2d) 677.)

IV.

AFTER THE COMMISSIONER CHALLENGED THE DEDUCTION AND FOUND IT TO BE ILLEGAL, THE DEDUCTION HAD TO BE CONSIDERED DISALLOWED RATHER THAN ALLOWED. THE DECISION OF THE COURTS BELOW THAT THE COMMISSIONER'S FAILURE TO AFFIRMATIVELY EXPRESS HIS ACTION CONSTITUTED A VALID ALLOWANCE OF THE ILLEGAL DEDUCTION, IS IN CONFLICT WITH THE DECISIONS OF THIS HONORABLE COURT AS TO THE EXTENT OF THE COMMISSIONER'S AUTHORITY.

The true effect of the challenge of the depreciation by the Commissioner, and the discovery of its illegality, was that it established that the deduction

did not come within the statute authorizing such deduction and the deduction must therefore be deemed to have been *disallowed*. This Court has stated:

> "Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed * * * obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms." *(New Colonial Ice Co. v. Helvering,* supra.)

In his own Regulations (Art. 23(l)-5, Reg. 101, Appendix hereto), the Commissioner has recognized the above rule by prescribing as to any depreciation deduction that "the burden of proof will rest upon the taxpayer to sustain the deduction claimed".

It is conceded in effect that the petitioner herein could not show that its depreciation deduction for 1932 to 1935 came within the terms of the statute (Sec. 23), which authorized a deduction for reasonable depreciation, so the deduction could not be allowed but had to be disallowed. The deduction being disallowed there was *no deduction allowed* in those years 1932 to 1935, so the adjustment of the basis for depreciation for later years had to be for the depreciation "allowable" since that depreciation would be greater than the zero amount allowed.

V.

THE TAXPAYER HAS THE RIGHT TO VOLUNTARILY CORRECT MISTAKES. THE DECISION OF THE COURTS BELOW THAT THE TAXPAYER COULD NOT CORRECT A MISTAKE IS CONTRARY TO CONCEPTS OF GOOD LAW AND IN CONFLICT WITH DECISIONS OF OTHER COURTS.

It is not good law or good sense to hold that a taxpayer must be infallible in interpreting so technical a law as the income tax law or suffer the hardship and burdens of his mistake without any right to voluntarily correct the mistake or to have the mistake corrected.

The petitioner had the right to correct its mistake and did so by preparation of revised depreciation schedules in collaboration with the Commissioner's agents and by the filing of amended returns for the years 1932 to 1935 which reported the correct depreciation, and the Commissioner should have given effect to those corrections in the computation of the depreciation deduction for the years here involved. (*Milford Trust Co. v. U. S. Dist. Ct. Conn.* (1945), 63 Fed. Supp. 618.)

The later examinations and acceptance of the amended returns by the Commissioner's agents, evidence with respect to which the District Court excluded, is confirmation of those returns, and even though the Commissioner successfully opposed the introduction of evidence with respect thereto on the ground that the examination and acceptance of the returns was a mistake and immaterial, there was no contention that the amended returns did not reflect

the correct depreciation deduction and correct net loss. The Court below should have accepted the evidence, to further illustrate the inequities inherent in the Commissioner's interpretation of the *Virginian Hotel Corporation* case. There is nothing in the income tax statutes or the *Virginian Hotel Corporation* case which prevents the Commissioner from considering and accepting the amended returns filed by petitioner in this case. The Commissioner must administer the income tax laws according to their provisions and has no authority or right to refuse to make an allowance provided for by the statute, or to make an allowance which violates the statute.

In computing the basis for depreciation as of December 31, 1935, the cost of the property should not have been reduced by any amount greater than the stipulated reasonable, correct and *allowable* depreciation for the years 1932 to 1935.

CONCLUSION.

It is respectfully submitted that the decision of the Courts below to the effect that Section 113(b)(1)(B) of the Internal Revenue Code was construed by this Honorable Court in the *Virginian Hotel Corporation* case, to foreclose or preclude a taxpayer who had taken an erroneous depreciation deduction from correcting the error, and to prohibit the Commissioner from correcting the error, is probably in conflict with or at least an unwarranted extension of this Court's decision, and is wrong.

The revenue statutes authorize the Commissioner to audit returns and correct errors, and if he finds an erroneous deduction he has no authority to allow it. The Courts below should have held, therefore, that when the Commissioner found the depreciation deduction to be illegal but made no adjustment of it because the adjustment would not be sufficient to result in a tax liability, the effect of his action was a *disallowance* of the deduction rather than an allowance of it. Whether the Commissioner can deliberately allow an illegal deduction is an important federal question which should be settled by this Court, especially since the decision of the Courts below answering the question in the affirmative appears contrary to earlier authorities on the subject.

It would seem a fundamental concept of a revenue law that a taxpayer should be afforded a medium for correcting a mistake, and the Courts below should have held that the filing of amended returns for the years 1932 to 1935 was permissible and effected the correction of the erroneous depreciation deduction taken on the original returns for those years. Whether the taxpayer must be bound or can be bound to an error on his original return (in the absence of estoppel), as held by the Courts below, is also an important federal question which should be settled by this Court. The decision of the Courts below that the taxpayer is precluded from correcting a mistake because of having reported it on a return is contrary to the decisions of other Courts.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of

its supervisory powers, in order that the erroneous interpretation by the Courts below of the decision of this Court in the *Virginian Hotel Corporation* case, and the erroneous construction by the Courts below of Section 113(b)(1)(B) of the Internal Revenue Code, may be corrected, and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals for the Ninth Circuit and finally reverse it.

Dated, San Francisco, California,
July 30, 1948.

Respectfully,
GEORGE H. KOSTER,
Counsel for Petitioner.

(Appendix Follows.)

Appendix

STATUTE AND REGULATIONS INVOLVED.

STATUTE:

Internal Revenue Code:

Section 23—In computing net income there shall be allowed as deductions:

(1) *Depreciation*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, * * *

Section 114(a) Base for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in Section 113(b) for the purpose of determining gain upon the sale or other disposition of such property.

Section 113(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; * * *

Section 113(b) The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

(B) In respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws * * *

REGULATIONS:

Treasury Department Regulations 101 relating to the income tax under the Revenue Act of 1938.

Art. 23 (1)-1. Depreciation.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income.

Art. 23 (1)-5. Method of Computing Depreciation Allowance.—The capital sum to be received shall be charged over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall

be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years.

Art. 23 (1)-9. Records of Depreciable Property.—In order that the verification of depreciation allowances claimed by the taxpayer may be faciliated, depreciation shall be recorded on the taxpayer's books, the amount measuring a reasonable allowance for depreciation either being deducted directly from the book value of the assets or preferably being credited to a depreciation reserve account, which should be reflected in the annual balance sheet. For the same reason the allowance shall be computed and recorded with express reference to specific items, units, or groups of property, each item or unit being considered separately or specifically included in a group with others to which the same factors apply. Also, the taxpayer's books shall show the basis of the depreciable property and any adjustments thereto, and, in cases where the basis of the property is other than cost, or value on March 1, 1913, or value at date of acquisition (as, for example, if the property was acquired by gift or transfer in trust after December 31, 1920), or through a reorganization of a tax-free

exchange (see particularly section 113(a)), the books shall show the data used in ascertaining such basis and the adjustments thereto. If a taxpayer does not desire to have his regular books of account show all of the factors entering into the computation of depreciation allowances, such factors shall be recorded in permanent auxiliary records which shall be kept with and reconciled with the regular books of accounts.

Art. 114-1. Basis for Allowance of Depreciation and Depletion.—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113-(a), adjusted as provided in section 113-(b), for the purpose of determining the gain from the sale or other disposition of such property except as provided in article 23(m)-3, relating to depletion based on discovery value, in article 23(m)-4, relating to percentage depletion in the case of oil and gas wells, and in article 23(m)-5, relating to percentage depletion in the case of coal mines, metal mines, and sulphur mines or deposits.

Art. 113(b)-1. The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect of any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under the Revenue Act of 1938 or prior income tax laws. The adjustment required for any taxable year or period is the

amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted. For example, the case of Corporation A discloses the following facts as of January 1, 1938:

Year	Allowed	Allowable	Allowed, but not less than amount allowable
1931	$6,000	$5,000	$6,000
1932	7,000	6,500	7,000
1933	6,500	6,500	6,500
1934	6,500	6,000	6,500
1935	5,000	6,000	6,000
1936	4,500	6,000	6,000
1937	4,000	6,000	6,000
	$39,500	$42,000	$44,000

The depreciation allowed but not less than the amount allowable in this example as of January 1, 1938 is $44,000, and the cost or other basis of the property is to be adjusted by that amount.